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UK: BoE Suggesting Markets have Been Too Complacent!

by Andrew Wroblewski*

The latest (February) BoE Inflation Report surprised few in confirming a somewhat more upbeat real activity outlook in coming years, with growth boosted by lower oil prices and easier financial market conditions. As a result, the much-reduced near-term inflation projections (which are very much driven by lower food and energy costs), in which the Y/Y CPI rate may turn negative for a while) is not the main story.

Instead, the fact that CPI inflation is expected to be rising afresh by the end of the year, and is seen above the 2% target at the end of the forecast horizon, does suggest that the market thinking embodied in the Report (ie that the first rate hike will only come by Q3 2016) may be complacent - NB money markets have already adjusted this view markedly in the last few days!

BoE More Upbeat.

Indeed, Governor Carney was keen to stress that the fall in inflation now unfolding should not mask the stronger underlying dynamics that will underpin UK output (and inflation) in due course. Notably, the current degree of slack (at around 0.5% of GDP) has almost halved compared to that envisaged three months ago, while the fall in CPI inflation is merely accentuating the boost from already rising wage growth.

DE View: However, the Report this time around still suggests that the BoE is putting less and less focus on the labor market but may be quite willing to start the (limited) hiking process even with prevailing inflation well below the 2% target. Further easing cannot be ruled out given the uncertainties facing the BoE, but the more likely rate-hiking cycle is likely to be gradual once it begins.

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